No. 22366

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

METROPOLITAN SAVINGS AND LOAN ASSOCIATION, a corporation, and FIDELITY SERVICE CORPORATION, a corporation,

Appellants,

vs.

WILLIAMS CONSTRUCTION CO., a corporation, and A. J. BUMB, Receiver,

Appellees.

ANSWERING BRIEF OF APPELLEE WILLIAMS CONSTRUCTION COMPANY.

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I.

STATEMENT OF JURISDICTION.

This is an appeal from a decision of the United States District Court for the Central District of California on the review, pursuant to 11 U.S.C. §67(c), of orders of a Referee in bankruptcy in the District Court of the Central District of California. Jurisdiction was had pursuant to 28 U.S.C. §1334, which provides:

> "District Courts shall have original jurisdiction . . . of all matters and proceedings in bankruptcy."

Jurisdiction over this appeal is conferred upon this Court by 11 U.S.C. §47.

The appellee herein urges this Court to affirm the decision of the lower court.

II.
STATEMENT OF THE CASE.

Appellee, Williams Construction Co., a corporation, is a debtor in a proceeding in the Bankruptcy Court under Chapter XI of the Bankruptcy Act. Appellee, A. J. Bumb, is the duly appointed and qualified receiver of Williams Construction Co. in the Bankruptcy proceedings.

Williams is a land developer having acquired the tract in 1963 that is in question on this appeal. Williams subdivided the property into 129 lots, of which 20 have been sold. The remaining lots owned by Williams consist of 109 lots. The sales prices of the lots that have been sold range between the sum of $12,500.00 and $15,000.00. [C. T. pp. 70-71]

Williams fully improved the lots in question. The lots overlook a fully developed golf course and are quality lots. They range in elevation from 590 feet to 720 feet. The lots are within a mile of the extension of the Pomona freeway, and within a mile and a half of a shopping center. All of the streets in the tract have been paved, the curbs and gutters put in, and the underground utilities installed. The area is zoned for single family residential use [R-I-8500]. [C. T. p. 69]

The highest and best use of the lots owned by Williams is for single family residence use which is consistent with the general development and zoning of the area. The size of the lots varies between 8500 square feet and 14,400 square feet. The lots present an inter-

esting variation of approach, shape, elevation, views and probable development. At least nine of the lots previously owned and sold have been fully improved with residences. The tract is located in the unincorporated community of Walnut Valley in the Southeast portion of the San Gabriel Valley in Los Angeles County and is south and adjacent to Fifth Avenue about 1500 feet west of Brea Canyon Cut Off. The exact tract number is 28140. [C. T. pp. 69-70]

The property was appraised by the estate's appraiser, Sam Jonas, for the total sum of $1,362,500.00 on September 30, 1966, which works out to an average of $12,500.00 per lot [R. T. p. 15, line 24]. The appellant's appraiser, Taylor Dark of Marshal and Stevens Company testified that the selling price of lots today would be $13,500.00 on an average [R. T. p. 269, lines 2-18]. Dark also testified that the fair market value if the lots were sold individually would be $1,200,000.00 plus [R. T. p. 350, lines 22-23]. The owner, Herald Williams, President of Williams Construction Co., testified that the property was higher in value than $12,-500.00 per lot, to wit, $14,000.00 to $16,000.00 per lot [R. T. p. 149, lines 3-4]. The appellant had no other expert testify on value who qualified as such expert. The equity of the appellees was the sum of $366,-183.00. [C. T. pp. 42, 43, 71]

The Referee stated the definition of fair market value acceptable to this proceeding when he said

> "[The definition by the United States Supreme Court is] the amount in cash that in all probabil-

> ity would be arrived at by fair negotiation between an owner willing to sell and a purchaser willing to buy given a reasonable time to negotiate." [R. T. p. 393, lines 2-9].

The Referee granted the restraining order by order filed on November 23, 1966. The receiver and debtor brought on an application to transfer lien of the appellants to the proceeds which was heard on November 28, 1966, and an order was granted to the receiver and the debtor dated January 17, 1967. The Referee in granting the order transferring the lien to the proceeds stated

> "That [Metropolitan Savings] will receive the lion's share [of sales proceeds], but I am going to permit the receiver in this case to keep a small amount of what is received from those individual sales merely to cover the administrative costs of these proceedings; possibly five percent, certainly not more than ten percent in any sale until there has been enough of this property sold to put your client in a position where the default has been cured." [R. T. p. 14, lines 8-17 of November 28, 1966 hearing].

The two orders consolidated for review and a Memorandum Opinion dated September 18, 1967, and Supplement to Memorandum, dated September 22, 1967, were entered by the District Court Judge. These matters are here upon appeal.

III.
SUMMARY OF ISSUES AND ARGUMENTS.

We are concerned here with the power of the court, in applying the laws of bankruptcy, to order a sale of property in which the debtor has a substantial interest, free of the encumbrance, and to order the transfer of the lien to the proceeds.

The issues most narrowly stated are:

1. Whether the court has the power to order the sale.

2. If so, whether the court has the power to determine the manner of the judicial sale—that is, whether it should be a sale in bulk or in parcels or lots.

But what in fact will be decided by this court is whether the debtor and a substantial number of general creditors, all of whom are creditors because of work done and materials furnished in the manufacture of the 109 lots, and all of whom are directly responsible for the value the property now enjoys, are going to be paid, or whether the appellant is going to be allowed to enrich itself far beyond the amount of its security.

A. The Court Has the Power to Order a Sale of Property, Subject to an Encumbrance, Free of That Encumbrance When the Value of the Property Exceeds the Value of the Encumbrance by More Than a Third of a Million Dollars?

The federal bankruptcy act empowers the court to order a judicial sale of a debtor's property free of an encumbrance when the secured creditor can be protected

by a transfer of its lien to the proceeds and such a sale will result in a benefit to the general creditors. Ordinarily the sale is to recover equity in the property, but there is a well established line of cases allowing such a sale even where the presence of an equity is doubtful. In the instant case the value of the property exceeds the value of the encumbrance by more than a third of a million dollars, and the presence of equity is well established. There are, in addition, numerous general creditors whose debts were incurred in connection with the transformation of the property into 109 separate lots. Hence there is more than adequate basis for the exercise of the power to order a judicial sale.

The power of the court to order a judicial sale is a derivative of federal law and is not merely a power acquired by reason of subrogation to those rights of the debtor created by the sovereignty of the state. The Receiver can exercise all rights acquired by subrogation, but these rights are separate from, and in addition to, the power of the court.

B. The Court Has the Power to Determine the Manner in Which the Judicial Sale Shall Be Conducted—That Is, Whether the Property Shall Be Sold in Bulk, or in Parcels or Lots.

The power to sell includes the power to determine the manner in which the sale should be held. The sale should, of course, be such as will bring the highest possible return from the property.

On the basis of more than 400 pages of testimony, the court concluded that as of September 30, 1966 the fair market value of the property was $1,362,500.00 and that the encumbrance was not more than $996,-

317.00. It also concluded that it would be in the best interest of the general creditors that the lots be sold separately with a transfer of the lien to the proceeds, and that a sale in this manner would in no way impair the substantive right of the secured creditor.

The Court was well within the limits of its power, and absolutely correct in its disposition of the matter. Its order is entirely consistent with the expectations of the parties. These lots were fully manufactured, with installed underground utilities. The curbs were installed and the streets paved. The area was zoned for single family dwellings and some of the lots had already been sold and had houses constructed on them. The parties intended that they be sold separately, and the release clause which the appellant relies on was designed to facilitate individual sales. The appellant attached a separate value to each, and the court indicated its intention to give the appellant even more than this fixed value from the sales as they take place.

There is no evidence that a lot by lot sale will impair the appellants' security. The appellant has speculated that it will be injured if only a portion are sold. But there is no evidence to this effect. Nor is there evidence that all the lots cannot be sold, or that any unsold lots will have a reduced value. On the contrary, it could be speculated that the value of the lots will increase as more and more are sold.

The evidence fully supports the findings of fact and the conclusions of law, and the orders should be affirmed.

IV.
ARGUMENT.

1. The Bankruptcy Act Empowers the Court to Order a Sale of Encumbered Property Free and Clear of All Claims, Liens, and Encumbrances.

The Bankruptcy act empowers the court to order the sale of all or any part of a bankrupt's property free of an encumbrance. This is an equitable power conferred on the court by the Federal Bankruptcy Act and is discussed in the Collier Bankruptcy Manual, under the section entitled "Sale Free of Liens and Encumbrances", as follows:[1]

> "The Bankruptcy Court (which includes the Referee) has the power to sell encumbered property free of all valid claims, liens and encumbrances, provided, in general, that the Bankruptcy Court has the actual or constructive possession of the property involved. Whether or not this power should be invoked is for the Trustee (or Receiver) to decide. [Footnote: The Court must exercise its discretion in ordering the sale after a determination of all relevant factors. *In re Bernard Altman Int'l Corp.,* 226 F. Supp. 201 (S.D.N.Y. 1963)].
>
> "In a petition for an order to sell free of liens and encumbrances, it must, as a rule, be shown that there is a benefit to be expected for the general creditors; that is, a surplus over and above the total amount of encumbrances and sale expenses. [Footnote to citations.] In exceptional cases, however, a sale free of liens may also be justified

[1]The Collier Bankruptcy Manual is under the editorship of a leading authority, Professor William T. Laube, of the law School of the University of California at Berkeley.

where the encumbrances equal the value of the property, and, where, for instance, the validity of some of the encumbrances is questioned, [Footnote to citations] or for reasons of a more expeditious and less expensive liquidation. [Footnote to citations]. The Bankruptcy Court may sell free of liens in some situations even though there may be some doubt as to whether or not there is any equity in the property for the unsecured creditor. [Footnote to following citations: *Matter of Hout,* 26 Am.B.R. (N.S.) 360, 9 F. Supp. 419 (D.C. Pa.); *Goggin v. Division of Labor Law Enforcement,* 336 U.S. 118, 69 Sup. Ct. 469, 93 L.Ed. 543 (1949)]." Collier, Bankruptcy Manual §70.54 (p. 1053).

This power is also discussed by the American Law Reports Annotated, in an extensive annotation. "Power of Court to Authorize or Direct Receiver (or Trustee in Bankruptcy) to Sell Property Free From Liens", 120 A.L.R. 921. See also:

Van Huffel v. Harpelrode, 284 U.S. 225, 76 L. Ed. 256 (1931);

Louisville Bank v. Radford, 295 U.S. 555, 583-584 (1935);

Gardner v. New, 329 U.S. 565, 576, 91 L. Ed. 516, 67 S. Ct. 473 (1946);

Arizona Power Corp. v. Smith, 119 F. 2d 888, 890 (9th Cir. 1941);

4A Collier on Bankruptcy, §§70.97[2] (p. 1131); 70.98[6] and [11] (pp. 1159 and 1165), and 70.99[1], [3], (p. 1214 *et seq.*).

On the basis of evidence presented, Referee Kinnison made the following Findings of Fact, *inter alia:* That

the property in question is subject to a Deed of Trust; that the fair market value substantially exceeds the amount of the encumbrance, that there is a substantial equity in the property; that the Debtor has certain unsecured creditors; that a sale of a lot free and clear of the lien will in no way impair the substantive rights of the secured creditor; that a sale of lots separately will bring a greater return than the sale of the lots as a unit; that it is in the best interest of the creditors that the lots be sold individually and the lien be transferred to the proceeds of such sale. Findings of Fact and Conclusions of Law, 5, 6, 7, 8, 9, 10, 11, 12 and 13 [C. T. pp. 69-70]. These Findings of Fact are well supported by the evidence and more than justify the court in exercising its power to order a foreclosure proceedings to be enjoined, and to allow a judicial sale of the lots, individually or in bulk, with a transfer of the encumbrance to the proceeds.

The source of the power of the court to order a sale of encumbered property should be carefully examined. The sale is an exercise of that power delegated by the states to the federal government at the time of the adoption of the federal constitution, which is embodied in Article 1, Section 8 of the United States Constitution. The sovereignty of the state did not, and has not, retained power to limit that which it delegated. The sale is not an exercise of a power acquired by reason of subrogation. The court is exercising a direct power over the property derived from federal law; it is not a derivative of state law.

In the last analysis, it would appear that the appellant concedes this. Appellant's real argument is not that the power to sell the lots individually does not

exist, but only that it would not be a realistic economic possibility to make such sales because "each lot would [necessarily] be subject to an encumbrance of approximately one hundred times its value[2] (Appellant's Op. Br. pp. 26-27).

Of course, if the security agreement itself creates special additional powers in the bankrupt, the trustee or receiver will be empowered to exercise those rights in the same manner the bankrupt could exercise the rights. But what is important here is to note that there are potentially two ultimate sources of power under which a sale free of the encumbrance can be made. Whether one or both exists in any given situation will depend on various questions of fact. This distinction may be illustrated by noting that, any time a bankrupt has encumbered property, there is a possibility that it can be sold free of the encumbrance, whether or not there is a release clause provision in the particular security agreement. Therefore, it cannot be said that the power to sell derives from the release clause.

Perhaps the appellants analysis is clouded with the hope that, should the court cause the property to be sold as a unit, it will eventually be able to bid in the amount of the security, obtain title to the various parcels, and then itself resell them on a lot by lot basis. The realization of this potential third of a million dollar profit is no doubt attractive. But should this excess

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[2]"Yet the only way in which, under the terms of the deed of trust binding upon the receiver, the bankruptcy court has the power to sell the lots free of liens as is a tract. A sale of the lots individually, subject to Metropolitan's lien, would obviously not be feasible; *each lot would be subject to an encumbrance of approximately one hundred times its value.*" (Emphasis added). (Appellant's Op. Br. pp. 26-27).

value go to the appellant, whose investment under any analysis is secured, or should it go to the existing unsecured creditors who have created the value that exists in the property by cutting lots out of raw acreage, installing the curbs, paving the streets, putting in the underground utilities, and carrying out all of the other activities requisite to manufacturing lots? It is the obligation, the responsibility, and the ultimate purpose of the bankruptcy court to recover the value for these general creditors, who will otherwise lose everything.

2. The Bankruptcy Court Has the Power to Decide Whether a Sale Free of Encumbrances Should Be in Bulk or in Parcels or Lots.

The power of the court to order a judicial sale of the lots free of the encumbrance includes the power to determine the manner in which the sale will be conducted—that is, whether it shall be a sale in bulk or in parcels or lots. If the facts indicate that a much higher price can be obtained from a sale in parcels or lots, then the court has an obligation to order that kind of sale.

Volume 4A, Collier on Bankruptcy, under the section entitled "Practice in Bankruptcy Sales", discusses this power as follows:

> "[6] Sale in Bulk or in Parcels.
>
> The order of sale should likewise specify the manner in which the property should be offered for sale—that is, in bulk, or in parcels, or lots. Creditors may express their wishes, the advice of the Receiver or Trustee will carry considerable weight, but the final decision is with the Bankruptcy Court. [Footnote: *Matter of Columbia Iron*

Works, 14 Am. B. R. 526, 142 Fed. 234 (D.C. Mich.)] The court may, however, by local rules, leave it to the discretion of the Receiver or Trustee to direct a sale in bulk or a sale in lots. Where some assets are encumbered with liens, it may be difficult properly to apportion the proceeds to the liens on the various parcels or lots, unless they are sold separately." 4A Collier on Bankruptcy §70.-98[6] (p. 1159).

See also 4A Collier on Bankruptcy §§70.97[4] (p. 1143) "Analysis of Power to Sell", and 70.99 [5] (p. 1222) "Sale Free of Liens and Encumbrances".

Whether there shall be a sale, and, if so, what kind, are questions of fact to be decided on the basis of the evidence.

In the instant case, after a hearing on the application to transfer the lien to the proceeds, the Referee made the following findings of fact:

"[8] That there is a substantial equity of the Debtor in the said property.

"[9] That the Debtor has certain unsecured creditors.

"[10] That the sale of lots separate will bring a greater return than the sale of lots on a wholesale basis. That said lots should be sold so as to obtain the highest possible price. (*Louisville Bank v. Radford* [1934], 295 U.S. 555, 584, 79 L. Ed. 1593, 55 S.C. 854.).

"[11] That it is in the best interests of the general creditors that said lots be sold separately, rather than on a wholesale basis." Findings of Fact and Conclusions of Law, 8-11." [C. T. pp. 69-70].

These findings of fact are supported by the expert testimony of several competent appraisers.

The court entered an order that was not only well within the scope of the proper exercise of its power, but was fully consistent with the intentions and the expectations of the parties at the time they entered the agreement. The security consisted of 109 separate, clearly defined, and fully improved lots. The streets had been paved; the curbs, gutters and underground utilities installed. The appellant itself valued each lot separately, and an examination of the trust deed reveals that the values were rather evenly distributed within the $8,000.00-$10,000.00 range [C. T. p. 4]. They were intended to be sold individually; some in fact had already been sold. The release clause was designed to facilitate such sales.[3]

The court is not dealing with a circumstance in which untouched acreage is to be arbitrarily portioned off at the whim of the Referee, so that perhaps a filling station could be constructed in the middle of what might otherwise be developed into a golf course. On the contrary, this is, in principle, akin to a situation in which two lots located in separate parts of the state are pledged to secure a note to which there remains unpaid an amount less than the value of both lots. In

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[3]It should be noted that the Referee intends to afford the appellant even more protection than simply the value it has attributed to the various lots. To quote from the opinion of the honorable Judge Whelan, quoting in turn the Referee: "As a practical matter, you have a release price there, it may be $8,000.00, and the sale price is $13,500.00. As a practical matter, I would require the payment of a substantial portion of the $13,500.00 to Metropolitan; not the $8,000.00. I would leave a small portion of it to the Receiver to carry on the expenses of administration of this estate, but the lion's share would go on that encumbrance to reduce that encumbrance" [C. T. p. 161].

such a circumstance, the court would certainly be correct in selling the lots separately.

The character of the property with which the Court was dealing is perhaps best summarized by quoting from the findings of fact entered pursuant to the application to stay the foreclosure proceedings. They are, in part, as follows:

> "[1] That Williams Construction Company, a California corporation, is the owner of the following described real property:
>
> Lots 1, 3, 5, 6, 7, 9, 10, 11, 13, 14, 18, 20 through 41, inclusive, 43 through 51 inclusive, 53 through 73 inclusive 78 through 86 inclusive, 88, 90 through 92 inclusive, 94 through 101 inclusive, and 104 through 128 inclusive, of Tract No. 28140, as shown in Map Book 709, pages 86 to 91 inclusive, Los Angeles County Recorder's office.
>
> "[2] The number of such lots owned by Williams is 109 lots which are fully improved lots in a subdivision zoned R1-8500, a single family residence zoning permitting subdivision development with a minimum lot size requirement of 8500 square feet.
>
> "[3] That the highest and best use of the lots owned by Williams Construction Company is for single family residence use which is consistent with the zoning and general development of the area.
>
> "[4] The tract is located in the unincorporated community of Walnut Valley in the Southeast Portion of San Gabriel Valley, and is south of and adjacent to Fifth Avenue, about 1500 feet west of Brea Canyon Cut Off.

"[5] The range in elevation of the tract goes from 590 feet at the Fifth Avenue entrance to the subdivision to approximately 720 feet along its most southerly lots. The range in lot size is from 8500 square feet to 14,000 square feet.

"[6] The lots present an interesting variation of approach, shape, elevations, views and probable development characteristics.

"[7] All streets in the subdivision are paved and have curbs and gutters; underground utilities have been installed. There are 9 lots in the tract, now owned by Williams Construction Company, which have been improved with residences.

"[8] The lots have been approved by a licensed geological engineer, and there is an easement over lot 48 for ingress." [C. T. pp. 41-42].

Eight of the lots of the original tract were sold in the first six months of 1965, for amounts ranging from $12,500.00 to $15,000.00. Finding of Fact 9 [C. T. p. 43]. These were not in any particular section, but were scattered throughout the tract. Homes have already been constructed on them.

The appellant is now before this court asking for a most unusual order. There has been a finding of fact that the property has a fair market value of $1,362,-500.00 [C. T. p. 70]; and that the value of the appellant's encumbrance is no more than $996,317.00 [C. T. pp. 43, 70]. Yet the appellant is asking the court to order a sale which, the appellant has offered to prove, can be expected to net no more than $924,-630.00 (Appellant's Op. Br. pp. 4-5).

The appellant has advanced two reasons in support of this request:

1. That if only a portion of the land is sold, there will be an impairment of the remaining security;

2. That there is a potential for injury to it in the form of an impairment of the relationship between the appellant and the Federal Home Loan Bank Board, of which the exact nature and extent is rather vaguely expressed.

To support these contentions, the appellant has offered arguments consisting almost exclusively of speculation. There is evidence in the record to indicate that the value of the property, if the method of sale is a lot by lot sale, is much greater than what the appellant has offered to prove could be the expected return from a "wholesale" liquidation. This is not speculation. There is no evidence to indicate that all of the lots cannot be sold on a lot by lot basis. There is no evidence that the time of the sale would necessarily be "three, four or five year"[s] Appellant's Brief, p. 24. There is no evidence to indicate that the value of the unsold lots will decrease as more and more lots are sold. And there is no evidence in the record relating to a "totally different class [of potential purchasers]." (Appellant's Op. Br. p. 22). If the court wishes to speculate, it might conclude on the basis of the transcript that any unsold lots would have an increasing value, as homes were built on those that were sold. It might also speculate that since the time of the evaluations of record, the cost of manufacturing similar lots has substantially increased, so that there is an even greater equity in the property than appears of record.

Speculation in this case is not only improper, but unnecessary. The bankruptcy court heard several hundred pages of testimony in which the character of the property, its marketability, and the nature of the security agreement were fully examined. At the conclusion, following the hearing on the application to transfer the lien to the proceeds, the court made the following finding of fact:

> "[12] That a sale of the said lots free and clear of the respondent, Metropolitan Savings and Loan Association, *will in no way* impair the substantive right of the respondent." (Emphasis added) [C. T. p. 43].

The bulk of the appellant's opening brief is a re-argument of this factual determination.

The fundamental objection running throughout the appellant's brief is that of the potential time delay involved. The appellee will not join in speculation about this, but will respectfully point out that there is a certain delay inherent in any extension of secured credit to a debtor who may ultimately be compelled to resort to the assistance of the bankruptcy law. Furthermore, the concept of fair market value necessarily implies a reasonable time in which to make the sale.

There is nothing in the record to indicate that any time delay is unreasonable in the circumstances. In fact, the delay thus far may be directly attributed to the activities of the appellant. This matter was first heard in September, 1966. Since that time the appellees have been able to make no sales of the property, not for lack of marketability, but because (and this is a matter of which the court may take judicial notice) the appel-

lants have maintained their encumbrance of record through this appeal, thereby preventing the issuance of any policy of title insurance on the property without setting forth such encumbrance as an exception. The real injury here is to the unsecured creditors whose contributions to the property have created its value. There is more than adequate security to fully protect the appellant. But during this time the property taxes must be paid along with certain maintenance expenses, all of which will reduce the equity. Perhaps interest is also accruing, but the appellee does not concede this because thus far the delay is directly attributable to the appellant.

3. There Is a Substantial Equity in the Property Which the Bankruptcy Court Can Recover for the General Creditors by Ordering a Sale Free of the Encumbrances.

Under the laws of bankruptcy, a federal definition of "equity" is of more significance, but even a California court when called upon to define "equity", for purposes of a fraud action, said:

> "Equity, when used in connection with real estate value, means a clear market value in excess of encumbrances upon a parcel of property." *Masten v. Fox West-Coast Theatres,* 117 Cal. App. 303.

Although this action does not involve fraud, the characterization is fitting.

The Bankruptcy Court made a finding of fact "that there is a substantial equity of the Debtor in the said property." Findings of Fact and Conclusions of Law, 9 [C. T. p. 69]. The dollar amount of this equity,

based on the findings of fair market value, is approximately $366,183.00 [C. T. pp. 43, 44].

The presence of this equity is a more than adequate foundation for the order by the Bankruptcy Court for the sale free and clear of the lien. 4A Collier on Bankruptcy, §§70.97[2], 70.99; Collier Bankruptcy Manual, §§70.03, 70.12[2], 70.52, 70.53, 70.54; Bankruptcy Act, §70a(5), 11 U.S.C. §110. See also Section 1 of the appellee's Argument herein.

Under the Bankruptcy Act, §70a(5), the Bankruptcy Court obtains jurisdiction over the bankrupt's title to

> "property, including rights of action, which prior to the filing of the Petition, he could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered. . . ."

The decision whether to issue an injunction prohibiting the foreclosure outside bankruptcy, and/or ordering a sale free of the encumbrance, is within the discretion of the Bankruptcy Court.

In order for the appellant to reach the conclusion that there is no equity, it must overlook a considerable amount of law, both on what constitutes "equity" and on the relationship between the presence of "equity" and the power of the court to order a sale. Among other things it must overlook the basic nature of the power to order a sale free of an encumbrance, as discussed in sections 1 and 2 of the appellee's Argument, herein. It must also overlook the power to sell when there may not be any equity. *Matter of National Grain Corp.,* 9 F. 2d 802, *In Re Keet,* 128 Fed. 651; See generally 4A Collier on Bankruptcy, §70.99[1] (pp. 1214-1215) "Sale Free of Liens and Encumbrances."

The power to sell exists when it can be shown that there is a benefit to be expected for the general creditors. *Monroe County Bank v. Dreher,* 88 F. 2d 288 (3rd Cir.); 4A Collier on Bankruptcy §70.54 (p. 1053). The exercise of the power to order a sale is very much within the discretion of the court, and like any discretionary power, could certainly be abused. But it can hardly be said that the decision to order a sale that could perhaps return approximately $366,183.00 in excess of the value of the encumbrance is an abuse of discretion.

The appellant advances at some length, in support of its dual contentions that there exists neither equity nor power to transfer the lien to the proceeds, the assertion that:

> "In the absence of a specific statutory provision to the contrary, a trustee in bankruptcy acquires no greater interest in the property than belonged to the bankrupt." (Appellant's Op. Br. p. 15).

While this statement contains a large element of undeniable accuracy, it is a misleading oversimplification that is irrelevant to a determination of the controlling issues presently before the court. Its procrustean application to this case would not only ignore the whole equitable nature of the court of bankruptcy,[4] it would

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[4]*Continental Illinois National Bank and Trust Company v. Chicago R. I. & P. Railroad,* 294 U.S. 648, 675, 55 S. Ct. 595, 79 L. Ed. 1110, discusses the equitable nature of the courts of bankruptcy in these terms: "[They] are essentially courts of equity, and their proceedings inherently proceedings in equity. . . . The power to issue an injunction when necessary to prevent the defeat or impairment of its jurisdiction is, therefore, inherent in a court of bankruptcy, as it is in a duly established court of equity. §252 of the Judicial Code, which authorizes the United States Courts 'to issue all writs not specifically provided for by

(This footnote is continued on the next page)

assume that the court is constrained to recognize only those rights acquired by subrogation; that the parties to a contract can limit the power of the bankruptcy court to determine the manner in which encumbered property can be sold;[5] and that the the narrowest possible limitations, for purposes of bank- concept of "equity" ought to have the narrowest possible limitations, for purposes of bankruptcy law.[6]

To illustrate the degree of oversimplification in the appellant's argument, the appellee refers to the Collier Bankruptcy Manual, wherein, following its discussion of this kind of argument and of some of the equitable powers embodied in the bankruptcy law, the editor concludes:

> "It is quite apparent, therefore, that the Act [Bankruptcy Act] confers certain rights and powers on the trustee over and above those accorded the bankrupt, and, in some cases, the bankrupt's creditors." Collier Bankruptcy Manual, §70.01 (p. 930).

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statute, which may be necessary for the exercise of their respective jurisdictions' recognizes and declares the principal . . . Moreover, by §2(12) of the Bankruptcy Act, (USC Title 11, Section 11), Courts of Bankruptcy are invested with such authority in equity as will enable them to exercise original jurisdiction of bankruptcy proceedings, including the power to 'make such orders, issue such process and enter such judgments in addition to those specifically provided for as may be necessary for the enforcement of the provisions of this act.' The Bankruptcy Court, in granting the injunction, was well within its power, either as a virtual court of equity, or under the broad provisions of §2(15) of the Bankruptcy Act or of §252 of the Judicial Code."

[5]Suppose the contract said, for example, that in the event of default all of the debtor's property must be sold at wholesale, or to an institutional buyer, or to people over six feet tall? Would the court be compelled to look to one of these markets alone to determine whether there was an equity in the property?"

[6]A curious result follows the appellant's offered definition. The debtor has a third of a million dollars in equity *if he can pay off the encumbrances in total,* but none if he cannot. The concept of equity was originated to avoid this kind of result.

The appellant has cited a number of cases in support of its contention that the court is limited because the debtor was limited,[7] none of which is controlling. They do not involve a substitution of remedy, nor a determination of the manner in which the property shall be sold. In each the official of the bankruptcy court was asserting rights acquired solely under the terms of the particular contract. As has been demonstrated, in this case the right to sell is a derivitive of the bankruptcy act itself, and is not dependent upon the presence or absence of a release clause in the particular security.

4. The Effect of a Release Clause in a Case Involving a Receiver, or Otherwise Involving the Rights of Third Parties, Has Not Been Determined Under California Law, and There Is Reason to Believe That a Presence of Equitable Considerations Would Induce a California Court to Give Effect to a Release Clause in Such a Circumstance.

The case before this court involves the power of the Bankruptcy Court to order a judicial sale of encumbered property, free of the encumbrance, and to determine the manner of sale appropriate in the circumstances. It does not involve the exercise of a right to sell created by the sovereignty of the state, which the Bankruptcy Court is empowered by reason of subrogation to effect. Therefore, the line of cases cited by the appellant, of which *Bradbury v. Thomas,* 135 Cal. App. 435 (1933) is one, are not determinative of the controlling issue before this court. Nevertheless, since the Referee could also exercise the power which he has acquired by rea-

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[7]Appellee does not concede the existence of any limitations, See Appellee's Argument, Section 4.

son of subrogation, a brief discussion of the California law is in order.

The first case dealing with release clauses is *S.F.L. Company v. Whaley,* 50 Cal. App. 125 (1920) and it should be read carefully. In this case, the parties did not attempt to place any limitation on the operation of a release clause. The court concluded that the release clause remained in effect after default, and that its exercise did not impair the remaining security. See page 138.

The next case in line is *Bradbury v. Thomas, supra.* Here the security agreement did place a limitation on the effect of a release clause by stating, "Mortgagor, while not in default, shall be entitled to a separate release. . . ." [135 Cal. App. 2d 435, 443]. That case involved only rights as between the mortgagor and mortgagee in an action brought by the mortgagor to quiet title to certain land, after default. This case did not involve a receiver, did not involve a bankruptcy, and did not in any way involve the rights of any parties other than the mortgagor and the mortgagee. There were no equitable considerations before the court, and the court was not unmindful of this, when it said:

> "It is obvious that the appellants relied solely on the release clause of the mortgage. This must be so, for it is the only provision which furnishes any force to their claim that they are entitled to have their title to 15 lots quieted against respondent's mortgage lien. Certainly, if the mortgage had contained no release provision there could have been no pretense on their part that they were entitled to have any of the mortgaged premises declared free from the mortgage lien." 135 Cal. App. 2d 435, 442.

In the present case, in the absence of a release provision, it is rather clear that the court could have ordered a sale in parcels or lots.

The most recent case involving a release clause is *Conley v. Poway Land and Inv. Co.,* 232 Cal. App. 2d 22 (1965). In this case also there was a release clause conditioning the right to retain the release

> "so long as the trustor be not in default concerning any of the covenants contained herein or with respect to the payments due on the promissory note secured thereby, . . ." At page 25.

Six months after default, the debtor requested and obtained a reconveyance of approximately 15 acres. The payment of principal, for which this acreage was released, had been made nine months prior to the default, and fifteen months prior to the actual reconveyance. At the time of the payment, however, there had been no request for a reconveyance, nor apparently any other effort to obtain one. Although the higher court could have set this reconveyance aside, it did not. The lower court was reversed and the debtor was allowed to obtain the reconveyance while in default.

The cases discussed stand for the proposition that the California courts have considered the situations on an ad hoc basis and no conclusion can be made that in a factual situation similar to the one here the courts would not permit sale of individual lots, particularly in view of rationale of *Whaley.* In the *Whaley* case the courts allowed a conveyance after default. If, as a matter of law, this would have been damaging to the remaining security, surely they would not have done so.

There is no California case involving a receiver, a bankruptcy, or otherwise involving the rights of third

parties in which it has been necessary to decide what effect must be given a release clause. A trusteeship or receivership presents a significantly different case. These offices, whether created by state or federal law, are equitable in nature and designed to protect the rights of third parties. In a case in which the rights of the secured creditors can be protected, and the rights of third parties are at issue, there is considerable reason to believe the California courts would give effect to a release clause.

V.
CONCLUSION.

For the foregoing reasons, the Appellee Williams Construction Company submits that the decision of the Court below is correct in every respect and should be affirmed.

Respectfully submitted,

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Certificate.

I certify that in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

MARK G. ANCEL